No. 92-1382

In the
Supreme Court of the United States
October Term, 1992

Medallion Oil Company, et al.,

Petitioners,

vs.

TransAmerican Natural Gas Corp., et al.,

Respondents.

Petition for Writ of Certiorari
to the United States Court of Appeals
for the Fifth Circuit

Brief in Opposition

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QUESTION PRESENTED

Whether this court should order the Court of Appeals for the Fifth Circuit to certify to the Supreme Court of Texas the following question: Can the lessee of an oil and gas lease destroy an overriding royalty by surrendering the lease while the lease continues to produce in paying quantities?

LIST OF PARTIES

The following is a list of all of the parties to the proceeding in the United States Court of Appeals for the Fifth Circuit, whose judgment is sought to be reviewed:

Appellants:
Medallion Oil Company
H.S. Finkelstein
A. David Benjamin Finkelstein Irrevocable Trust
Susan Raphael Finkelstein Irrevocable Trust

Appellees:
TransAmerican Natural Gas Corporation
TransAmerican Pipeline Corporation
Southern States, Inc.
Southern States Exploration, Inc.
Laredo Exploration, Inc.
Southern Petroleum Trading Co., Ltd.
TransAmerican Gas Transmission Corporation
JRS Realty, Inc.

The respondents have no parent companies or subsidiaries within the meaning of Supreme Court Rule 29.1.

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TO THE UNITED STATES SUPREME COURT:

Pursuant to rule 15.2 of the Supreme Court Rules, respondent TransAmerican Natural Gas Corporation files this brief in opposition to the petition for writ of certiorari and asks that this court deny the petition.

OPINIONS AND JUDGMENTS BELOW

The opinions and judgments delivered in the courts below are as follows:

Medallion Oil Co. v. TransAmerican Natural Gas Corp. (In re GHR Energy Corp.), 979 F.2d 40 (5th Cir. 1992) (on rehearing).

Medallion Oil Co. v. TransAmerican Natural Gas Corp. (In re GHR Energy Corp.), 972 F.2d 96 (5th Cir. 1992) (on the merits).

Medallion Oil Co. v. TransAmerican Natural Gas Corp., No. H-91-1564 (S.D. Tex. Oct. 3, 1991) (on appeal from the bankruptcy court).

In re TransAmerican Natural Gas Corp., No. 84-03474-H1-5 (Bankr. S.D. Tex. May 14, 1991) (original decision).

JURISDICTION

The respondents do not contest the facts alleged in the petitioners' statement of jurisdiction.

CONSTITUTIONAL PROVISION AND RULE INVOLVED

Tex. Const. art. V, § 3-c:

(a) The supreme court and the court of criminal appeals have jurisdiction to answer questions of state law certified from a federal appellate court.

(b) The supreme court and the court of criminal appeals shall promulgate rules of procedure relating to the review of those questions.

Tex. R. App. P. 114(a):

(a) Certification of Questions of Law. The Supreme Court of Texas may answer questions of law certified to it by the Supreme Court of the United States or a Court of Appeals of the United States when requested by the certifying court, if there are involved in any proceedings before the certifying court questions of law of this state which may be determinative of the cause then pending and as to which it appears to the certifying court that there is no controlling precedent in the decisions of the Supreme Court of Texas. The Supreme Court may, in its discretion, decline to answer the questions certified to it.

STATEMENT OF THE CASE

I. Factual background of the dispute.

This case involves the construction of a contract between the petitioners, Medallion Oil Company and H.S. Finkelstein ("Medallion") and Good Hope Refineries, Inc., ("TransAmerican") who was the predecessor of respondent TransAmerican Natural Gas Corporation.

In 1974 Medallion and TransAmerican agreed that TransAmerican would assign to Medallion an overriding royalty interest in oil and gas production from mineral rights Medallion would assist TransAmerican in obtaining.

In 1975 El Paso Natural Gas Company ("El Paso") and TransAmerican entered into a farmout agreement whereby El Paso granted to TransAmerican the right to explore, develop, and thereby obtain natural gas leases on the La Perla Ranch in Zapata County, Texas. The farmout agreement between TransAmerican and El Paso set forth the language of the lease which El Paso would grant to TransAmerican. The lease provided that, subject to the other provisions therein, it would remain in full force and effect so long as gas was produced from the properties subject to the lease. However, one other provision of the leases provided that TransAmerican had the sole, absolute right to surrender the leasehold.

In 1987 TransAmerican and Medallion entered into a settlement agreement which resolved disputes raised during the course of the bankruptcy proceeding which TransAmerican had filed four years earlier. Among other things, TransAmerican agreed to convey to Medallion an

overriding royalty in the net revenue that TransAmerican acquired under its farmout agreement with El Paso, and an overriding royalty in production from the leases on the La Perla Ranch as of the date of the TransAmerican/ Medallion agreement. In addition, the agreement allowed TransAmerican to terminate at will any interests it had obtained in the property, including leases obtained under the El Paso farmout agreement.

In 1990 TransAmerican and El Paso settled a dispute over a gas purchase agreement that covered certain gas produced from the La Perla Ranch. Pursuant to the terms of the settlement agreement, TransAmerican terminated all prior agreements between it and El Paso, including the 1975 farmout agreement and all oil and gas leases thereunder, and El Paso assigned to TransAmerican all of its mineral interests in the La Perla Ranch. TransAmerican thereby obtained the fee mineral estate underlying the La Perla Ranch and continued to produce gas from the property.

II. Course of proceedings and disposition below.

During the course of TransAmerican's bankruptcy proceeding, Medallion filed a motion with the court to compel TransAmerican's compliance with the parties' 1987 settlement agreement. Medallion alleged that under the agreement TransAmerican owed Medallion overriding royalties from leases TransAmerican obtained under the El Paso farmout agreement. TransAmerican argued that it did not owe any overriding royalties to Medallion because the farmout agreement and leases, upon which Medallion's overriding royalties were based, had been terminated between TransAmerican and El Paso.

The bankruptcy court granted summary judgment for TransAmerican on Medallion's motion to compel. The court properly determined that the 1987 settlement agreement between TransAmerican and Medallion had superseded their prior 1974 agreement with regard to TransAmerican's overriding royalty obligations to Medallion. The court concluded that the agreement allowed TransAmerican to terminate its leases at any time, and that because the leases gave TransAmerican the sole right to surrender the lease, TransAmerican was entitled to surrender the lease and thereby terminate its overriding royalty obligations to Medallion. The bankruptcy court based its decision on Texas law. On appeal, the district court affirmed the bankruptcy court's decision.

On appeal to the court of appeals, Medallion did not initially ask the court to certify to the Supreme Court of Texas any issues of state law. Instead, it argued that Texas law does not permit a lessee to cancel an overriding royalty interest by surrendering a lease on property where there is production of gas in paying quantities. Medallion asked the court to reverse and reform the judgment below.

The court of appeals affirmed the judgment. In its petition for rehearing Medallion reurged its argument that *Cain v. Neumann*, 316 S.W.2d 915 (Tex. Civ. App. — San Antonio 1958, no writ) was the controlling authority. In the alternative, Medallion for the first time asked the court of appeals to certify to the Supreme Court of Texas this question of law: "Can a lessee destroy an overriding royalty by 'surrendering' the lease while it continues to produce in paying quantities?" However, Medallion nevertheless insisted that Texas law provided a clear answer to this question through the decision in *Cain v. Neumann*.

Contrary to Medallion's contention, the court of appeals did not concede in its opinion on rehearing that Texas law in this area is unsettled. Instead, it concluded that this case was factually distinguishable from *Cain v. Neumann* and *Sunac Petroleum Corp. v. Parkes*, 416 U.S. 798 (Tex. 1967). The court properly determined that this case turned on the provision in the Medallion agreement that permitted TransAmerican to terminate its leases at will, and on the presence in the TransAmerican/El Paso lease of a "surrender" clause which expressly allowed TransAmerican to terminate the lease.

SUMMARY OF THE ARGUMENT

Through the subterfuge of asking for review of the court of appeals' refusal to certify a question of state law, Medallion essentially asks this court to review a decision in a diversity case based solely on state law grounds. In addition, Medallion seeks certification of a question that does not control this case. The controlling issue in this case is whether the agreements between the parties *in this case* prohibit TransAmerican from terminating overriding royalties Medallion obtained under those agreements.

In addition, this court should decline to engage in the dubious task of second-guessing the courts of appeals' refusal to certify a question of state law, especially where a party did not request certification until doing so, as an afterthought, in its petition for rehearing.

ARGUMENT

I. The record does not raise the question presented in the petition.

Medallion contends that the following issue was the controlling question that the court of appeals should have certified to the Supreme Court of Texas:

> Can the lessee of an oil & gas lease destroy an overriding royalty by surrendering the lease while the lease continues to produce in paying quantities?

Petition at 8. The Supreme Court of Texas is under no obligation to decide a question of law certified to it from a federal court. It may decide to do so, however, if the question of law "may be determinative of the cause then pending." Tex. R. App. P. 114(a). Medallion's request for certification did not involve a question determinative of the case before the court of appeals.

The court of appeals decided this case based on its construction of the parties' contracts. Contrary to what Medallion suggests, the court was not presented with any "unsettled question of state oil and gas property law" and the court did not attempt "to predict Texas property law." Petition at 15, 16. The court did not hold, as Medallion suggests, that "Texas property law permits the destruction of overriding royalties although production continues." Petition at 15. The court did not address property law issues at all.

Instead, the court concluded that where a party executes an agreement that expressly permits destruction of that party's overriding royalties, the party cannot avoid the agreement. 972 F.2d at 100. Reaching this decision did not nullify or ignore the principle of merger or any other aspect of Texas oil and gas law. The court found such principles inapplicable, and it decided the case by reading the 1987 TransAmerican/Medallion settlement and the leases that TransAmerican obtained from El Paso on the La Perla Ranch. *Id.* at 99-100.

In short, the controlling issue in this case was not whether a lessee can surrender a lease with production in paying quantities and thereby destroy overriding royalties. The issue was whether, given the specific provisions of the parties' contracts in this case, Medallion had contracted away its right to receive overriding royalties in the case where TransAmerican decided to surrender its lease. This is not the issue that Medallion asked the court of appeals to certify.

II. This case does not present grounds for ordering the court of appeals to certify a question of law.

Rule 10 of the Supreme Court Rules, while neither controlling nor fully measuring the court's discretion, indicates the character of reasons this court will deem important in reviewing a petition for writ of certiorari. Sup. Ct. R. 10.1. This case does not come within any of the reasons set out in rule 10.1. The court of appeals' opinion does not decide issues of federal law and does not conflict with any other federal courts' decisions. Nor does it represent departure from the accepted and usual course of judicial proceedings.

In *Lehman Bros. v. Schein*, 416 U.S. 386 (1974), Justice Douglas encouraged the use by courts of appeals of the certification procedures made available by a state's legislature, but he noted that resort to the procedure was not obligatory *Id.* at 390-91. Justice Rehnquist concurred, emphasizing that the use of such a procedure is very much a question of the considerable discretion of the federal court in going about the decisionmaking process. "If a district court or court of appeals believes that it can resolve an issue of state law with available research materials already at hand, and makes the effort to do so, its determination should not be disturbed simply because the certification procedure existed but was not used." *Id.* at 394-95 (Rehnquist, J., concurring).

The discussion in section I *supra* indicates that Medallion's argument that the court of appeals abused its discretion in failing to certify this question has no merit. The court resolved the issues before it by applying the state law discussed by the parties. Before the court issued its decision, Medallion did not suggest that the present state of Texas law did not provide an adequate basis for decision. On the contrary, Medallion repeatedly argued that *Cain v. Neumann* provided the appropriate basis for the decision. Thus, Medallion's own arguments to the court of appeals show that certification was not necessary. There is no reason for the delay and expense that Medallion's delayed request for certification would entail.

Medallion contends that its request was belated only because the court of appeals did not make clear, until its decision, that there was a basis for requesting certification. This is not true. Rather, Medallion complains of the court's refusal to adopt Medallion's argument as to the applicability of *Cain v. Neumann* and

the inapplicability of *Sunac Petroleum Corp. v. Parkes*, 416 U.S. 798 (Tex. 1967). Medallion even explains its delay in these terms, stating that it was not until the court had issued its decision that Medallion knew that the court had "erroneously relied upon *Sunac* to decide this case." *See* Petition at 11 n.4. Thus, Medallion's real complaint is not about the court's failure to certify, but about its failure to adopt Medallion's arguments as to the application of state law.

Seen in this light, Medallion's late request for certification appears more clearly to be the subterfuge that it is — a last-minute attempt to introduce into a diversity case an issue that only superficially provides a basis for seeking this Court's review of the decision.

Medallion has urged this court "to remind the lower federal courts of their duty to certify important, unresolved questions of state law to state courts." Petition at 10. Yet Medallion did not complain until its petition for rehearing that this case involved an unresolved question of state law. In such circumstances, the additional time and money that certification would require would make the court's refusal to certify a proper use of discretion, without regard to whether the question to be certified was truly a controlling issue that required resolution. In view of the lateness of Medallion's suggestion for certification, the question of whether certification would have better advanced the goal of correctly disposing of this case is best left to the sound judgment of the court of appeals. *See id.* at 395.

Medallion also argues that the lower courts are badly in need of criteria to use in deciding certification questions. Petition at 10. It then proposes that this court mandate the application of the factors which the court of

appeals itself explained in *Florida ex rel. Shevin v. Exxon Corp.*, 526 F.2d 266, 274-75 (5th Cir.), *cert. denied sub nom. Standard Oil Co. v. Florida*, 420 U.S. 829 (1976). If those factors provide an appropriate guide for certification by the federal courts, then why should this court be asked to impose those factors on a court that has indicated that it accepts them? Medallion gives no reason for believing that the court of appeals did not follow its own standards for certification in this case.

CONCLUSION

For these reasons, this court should deny the petition for writ of certiorari.

Respectfully submitted,

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